

PR18 working paper

Working paper 8: Managing change affecting the PR18 settlements

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Overview

This paper forms part of the 2018 periodic review (PR18), and follows on from our conclusions to our July 2017 consultation of the overall framework for regulating Network Rail¹, which set out how we are changing the way we regulate Network Rail to focus on its routes and its system operator (SO) function.

It is important that Network Rail is able to adapt to changing circumstances. Therefore, in PR18 we are seeking to combine the benefits of certainty regarding future funding (thus allowing routes to plan and hence reduce costs), with increased flexibility to respond to existing and new customers' needs, through incorporating Network Rail's scorecards in our regulatory approach.

Certain potential changes in CP6 may weaken the routes'/SO's ability to plan, as well as undermining our ability to compare them and hold them to account, and therefore reduce the value of the PR18 settlements. This is particularly a feature for the new control period because there will be separate settlements for each route and the SO. This is a new feature for England & Wales but not for Scotland, for which there is ring-fenced funding.

We are therefore developing an approach, as set out in this working paper, to support the objective of achieving a balance between:

- the benefits of Network Rail as a whole being able to respond flexibly, for example to changing circumstances or balancing risks across its England & Wales business; against
- the benefits of our settlement, in terms of
 - providing assurance to routes and the SO regarding their responsibilities and funding (allowing them to plan and manage their businesses); and

¹ <http://orr.gov.uk/rail/consultations/pr18-consultations/consultation-on-the-overall-framework-for-regulating-network-rail>

- providing the framework for us to hold routes and the SO to account, including through comparing information across routes.

The managing change process will focus on changes that undermine the PR18 settlement. These will typically take the form of:

- substantial organisational changes, in particular in the form of a substantial shift of responsibilities of the routes or SO;
- route boundary changes (which will be more relevant to routes in England & Wales than in Scotland);
- reductions in funding for individual routes/the SO (which, due to ring-fenced funding, will not be relevant to the Scotland route); or
- changes to what a route is expected to deliver as a result of, for example, an enhancement decision.

To ensure our approach is proportionate, we distinguish levels of change, where level II is a material change relative to our PR18 settlements, and level III is a fundamental change relative to our PR18 settlements. We are principally concerned with changes that would not occur if the routes/SO were independent commercial businesses: changes originating within the route/SO concerned are outside the scope of this process.

Our approach builds up from smaller to larger changes:

- reporting requirements (levels I, II, III);
- assurance and/or requirements regarding wider transparency and governance (levels II, III); and
- publishing our formal opinion on the proposed change (level III).

In addition, we may make a decision, with reference to Network Rail's licence, to prevent an 'exceptional change'. This would only apply for level III changes where there is no reasonable means available to us to mitigate the serious impact of the change. In reaching our decision, we would take account of the benefits of the change, with reference to our statutory duties. Alternatively, we may decide to reopen our determination under the provisions in track access contracts.

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Responses and engagement on this paper are requested by 27 April 2018

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1. Paper structure & how to respond

1. Different stakeholders are expected to have different levels of interest in managing change affecting the PR18 settlements and this paper has been split into two parts accordingly.
2. Part 1 is designed to be accessible to a wider range of industry stakeholders and sets out our policy, which we have developed further since our January 2018 conclusions on the overall framework. Our key policy developments relate to our explicit focus on 'extra-route changes', which are changes that occur outside the routes/the SO; and in certain circumstances using Network Rail's licence to prevent exceptional changes.
3. Part 2 may appeal to a narrower audience as it sets out how we see the approach being operationalised for different types of change. We set out how we categorise change into levels, and the proposed process and treatment of change for those levels. We also set out how we want to use Network Rail's existing processes - notably Network Rail's business planning process, its arrangements with respect to scorecards, and governance around enhancements.
4. In Appendix A we set out the expected impacts of the managing change process on different stakeholders. In Appendix B we set out a draft change notification template.

Timing for concluding on this working paper

5. In the coming months we will continue engaging with stakeholders – both bilaterally and through forums such as Rail Delivery Group's (RDG) PR18 working groups – on the issues set out in this working paper.
6. We will set out our policy on managing changes affecting the PR18 settlements as part of our PR18 draft determination, which we will publish in June 2018. At the same time, we will conclude on the proposals we set out in this working paper, and may set out relevant draft licence provisions.
7. We will publish our final determination in October 2018. We propose to introduce the managing change process as part of the final determination to enable consideration of all changes that lead to a deviation from the settlements, including changes that are in routes' delivery plans, which will be published prior to CP6.
8. To start the implementation of PR18, we plan to issue review notices in December 2018, including proposed changes to Network Rail's network licence.
9. We will continue to work with Network Rail to ensure that the arrangements proposed in this working paper are introduced effectively and proportionately. This will include setting out Network Rail's reporting requirements in the data protocol that we are developing.

Responding to this paper

10. Working papers are intended to facilitate a more dynamic process of engagement and consultation with stakeholders, to support an iterative approach to developing policy. We therefore welcome all responses to the paper, including less formal responses such as emails, bilateral or multilateral discussions on any aspects covered in the paper, as well as alternative ideas and proposals.
11. Where written responses are made to us (particularly more formal responses), we may publish these on our website. If you wish any information that you provide, including personal data, to be treated as confidential, please say so in your response (an automatically generated confidentiality disclaimer by IT systems will not necessarily be sufficient in this respect). However, please be aware that regardless of any such request, we may be obliged to disclose or release any submissions made to us under the access to information regimes, such as the Freedom of Information Act 2000 or Data Protection Act 1998. Further information about how we may treat your response is available in paragraphs 6.40-6.43 of our [initial consultation](#)² on PR18.
12. Responses and engagement on this paper are requested **by 27 April 2018**. Please submit your responses to nicholas.hall@orr.gsi.gov.uk.

Questions

We welcome comments on any aspect of this paper. However, the questions below highlight some issues you may wish to consider in your response to the respective parts of the paper.

Part 1:

1: Do you have any comments on our proposed approach for focusing on changes originating outside of the route (extra-route changes)? How should this concept be adapted for the FNPO or SO, if at all?

2: What are your views on our proposed approach for categorising and treating different changes depending on the extent of their impact on the PR18 settlements?

3: Do you think there should be some exceptional changes that, with reference to Network Rail's licence, we would be able to prevent? If so, what forms of change should this include?

² http://orr.gov.uk/__data/assets/pdf_file/0009/21996/pr18-initial-consultation-document-may-2016.pdf

Part 2³:

4: Do you agree with our definitions of levels of change? Can you suggest improvements to these definitions?

5: How could the managing change process outlined be further improved to achieve its objective of maintaining the benefits of our settlements, while allowing Network Rail as a whole the ability to flexibly manage the business?

³ Part 2 of the paper is focused on the mechanics of the managing change process and the detail of how this might work in practice. This content may only be of interest to a more select group of stakeholders and some responders may therefore only wish to respond on questions 1-3.

PART 1: POLICY ON MANAGING CHANGE

2. Introduction

13. We set out our policy on managing changes that affect the PR18 settlements as part of our January 2018 conclusions on the overall framework. In part 1 of this working paper, we refine and build on our policy. We have refined how we describe the aim of this process and how we define different sizes, or 'levels'⁴, of change. The key policy developments that we propose in this working paper are:
- our explicit focus on 'extra-route change', i.e. changes that occur outside the routes/the SO; and
 - in certain circumstances, our use of Network Rail's licence to prevent exceptional changes.
14. In addition, since our overall framework consultation, we have incorporated into this process changes that are a consequence of network enhancements.

Objective of the managing change process

15. The purpose of the managing change process, which is the process that we develop in this working paper, is to support the objective of achieving a balance between:
- the benefits of Network Rail as a whole being able to respond flexibly, for example to changing circumstances or balancing risks across its England & Wales business; against; and
 - the benefits of our settlement, in terms of:
 - providing assurance to routes and the SO regarding their responsibilities and funding (allowing them to plan and manage their businesses); and
 - providing the framework for us to hold routes and the SO to account, including through comparing information across routes.
16. This is to support our PR18 aim of a more efficient, safer and better used railway, delivering value for passengers, freight customers and taxpayers in CP6 and beyond.
17. In our determination we will distinguish between England & Wales and Scotland, reflecting the different national funders and their separate High Level Output Specifications (HLOSs). This separation will be maintained throughout the control period (for example changes in funding for an English route will not impact the funding available for Scotland or vice versa). In light of this, some of the changes – in

⁴ We have previously referred to level I, II and III changes as small, medium and large.

particular relating to funding or boundary changes - set out in the working paper will be of limited relevance to Scotland.

18. The managing change process applies to Network Rail's geographic routes, the freight and national passenger route (FNPO) and the system operator (SO). For all of these entities, the objectives of the managing change process are the same. However, the value of maintaining robust comparison data will be most relevant to the geographic routes.

The concept of undermining the PR18 settlements

19. Box 1.1 sets out what we mean by the PR18 settlements.

Box 1.1: The PR18 settlements

In our PR18 determination we will set a settlement for each of the geographic routes and the FNPO (together 'the routes'), and the SO.

Each settlement consists of:

- **the funding for that route (or the SO) for the whole of CP6**. This takes account of, amongst other things, our assessment of the route's planned expenditure (including both direct costs, or those costs allocated/charged from other Network Rail functions, such as Infrastructure Projects); and
- **the outputs we expect the route or SO to deliver over CP6** (and beyond), in terms of services to current and future customers. They will be based on commitments made in their strategic plan, and in particular the scorecards. They will include any reasonable requirements that we set with respect to Network Rail's licence, for example to secure an output specified in an HLOS.

The settlements take account of and are made with reference to the responsibilities of each route and the SO, including the geographical area that they cover.

These, together with the operating parameters and responsibilities outlined in the network licence, the determination and associated supporting documents, make up the PR18 settlement for each route.

20. Where there is a material change to one or more of these key elements, the integrity of the settlement may be compromised and its benefits undermined.

Principles of the managing change process

21. To have sufficient confidence that Network Rail has the right incentives to deliver against the settlements and to improve throughout CP6, we need to balance the need for changes to take place, against the need to ensure that any changes that Network Rail seeks to make remain in step with how the company is regulated.
22. We will seek to minimise the regulatory burden on Network Rail through adherence to the following principles. The managing change process will be:
 - **proportionate** (we shall focus our monitoring on changes which have the most important impact on the settlements);
 - **consistent** (unless there are good reasons for differences), both over time and across different types of change; and
 - **transparent** (helping the industry to understand what changes are occurring over the control period that impact the settlements and what process has been followed to consider them).

3. Scope and levels of changes

Changes in scope of the managing change process

23. To ensure that the managing change process is proportionate and any regulatory requirements are minimised, we have developed an approach to isolate the subset of changes which have the potential to undermine the PR18 settlements and assess the extent of their impact.
24. As we set out in our overall framework conclusions, we think that the key changes that undermine the PR18 settlements are:
- substantial organisational change, in particular in the form of a substantial shift of responsibilities of the routes or SO;
 - route boundary changes (relevant for the geographic routes in England & Wales only);
 - reductions in funding for individual routes/the SO (not relevant for the Scotland route); and
 - changes to what a route is expected to deliver as a result of, for example, an enhancement decision.
25. Box 1.2 sets out the relationship between the PR18 settlements and the routes' and SO's business plans.

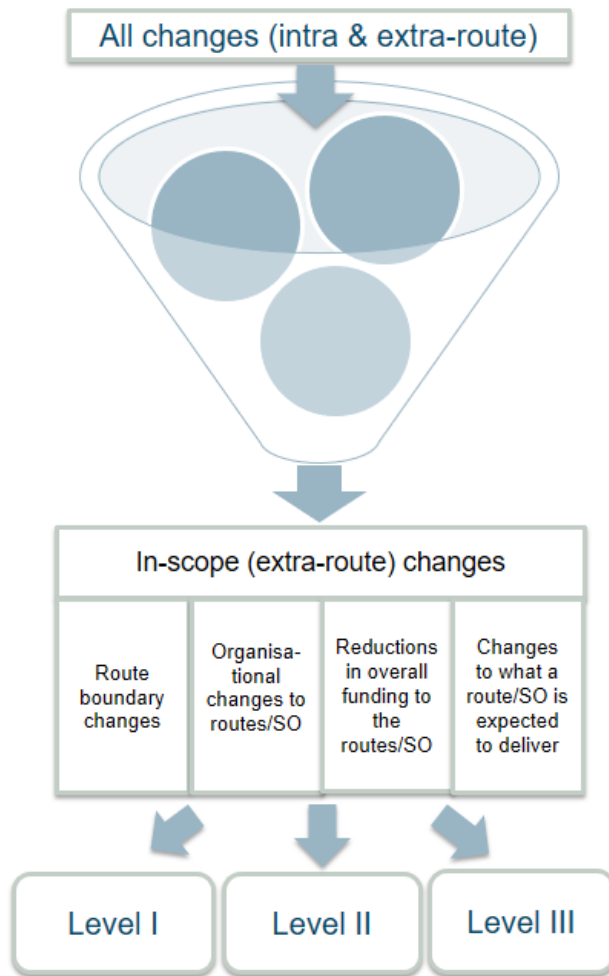
Box 1.2: How this relates to routes' and the SO's business plans

We will set the PR18 settlements for each route and SO, as part of our PR18 determination, on the basis of their strategic plans. Prior to the start of CP6, we expect the routes and SO to update their plans (their 'delivery plans') so that they are consistent with the PR18 settlements. In accordance with Network Rail's business planning processes, they will update their business plans at least annually after that.

The managing change process relates to changes that undermine the settlement. In practice, these changes would also necessitate significant changes to relevant business plans. The settlements are therefore intrinsically related to Network Rail's business plans. However, as Figure 1.1 shows, most changes, many of which may affect Network Rail's business plans, will not undermine the settlements.

26. Figure 1.1 illustrates how our approach is only concerned with a small number of changes to routes and the SO. The figure shows two important concepts, extra-route changes and different levels of changes, which we set out in the next two sections.

Figure 1.1: Filtering of changes that are relevant to the managing change process



Extra-route changes

27. We are developing this process because for PR18 there will be separate settlements for business units within Network Rail. Therefore, in broad terms, we are focusing on those changes that occur to the routes/the SO that would not occur if they were independent businesses.
28. We propose to distinguish between changes driven by an individual route/the SO and changes made to the route/the SO (typically caused by the action or decision of a party outside of the route (e.g. Network Rail centre, another route, funder etc.) which

mandates the route to make a change, resulting in all changes being classified into two broad change types as follows:

- **Intra-route changes** – changes initiated by a route/the SO or should reasonably have been factored into the route’s PR18 strategic plan⁵; or
- **Extra-route changes** – changes that originate outside of a route/the SO and could not have reasonably been factored into the route’s PR18 strategic plan.

29. The requirement for an extra-route change to be something which the route/SO could not have reasonably have factored into its strategic plan reflects the fact that good risk-management is a key responsibility of any well-functioning business (e.g. managing adverse winter weather, cost pressures due to supply chain issues and financial risks). These are therefore not deemed extra-route changes.
30. Similarly, the nature of the FNPO and the SO are such that they will frequently be impacted by changes driven by other parties (e.g. the FNPO’s scorecard measures will be impacted by the performance of the other routes and the SO will need to react to the needs of funders). Managing such risks is integral to the function of the FNPO and the SO and should therefore be anticipated and factored into their PR18 business plans. Table 1.1 provides examples of intra and extra-route changes.

Table 1.1: Examples of intra and extra-route changes

Intra-route change	Extra-route change
Route led organisational restructure of route-specific teams	Organisational change: Network Rail centre led organisational change substantially affecting the allocation of responsibilities between the routes and/or the SO and other parts of Network Rail
Two routes agree minor changes to responsibilities for assets in a boundary area	Route boundary change (where Network Rail centre chooses to change the geographic areas or transfer the assets that routes are responsible for, or to create extra routes or amalgamate existing routes)
	Changes to what a route is expected to deliver: National funder enhancement which the route was unable to include in its business plan in accordance with the enhancement pipeline process guidance
An alliance originated by the route and operator outside the franchising process	Changes to what a route is expected to deliver: An alliance with an operator organised through the franchising process
Route’s reallocation of the planned expenditure to other purposes within the route	Reduction in funding for an individual route: The occurrence of a significant event which necessitates a material reduction in route/SO funding despite all appropriate risk mitigation strategies being utilised

⁵ On which the settlement is based.

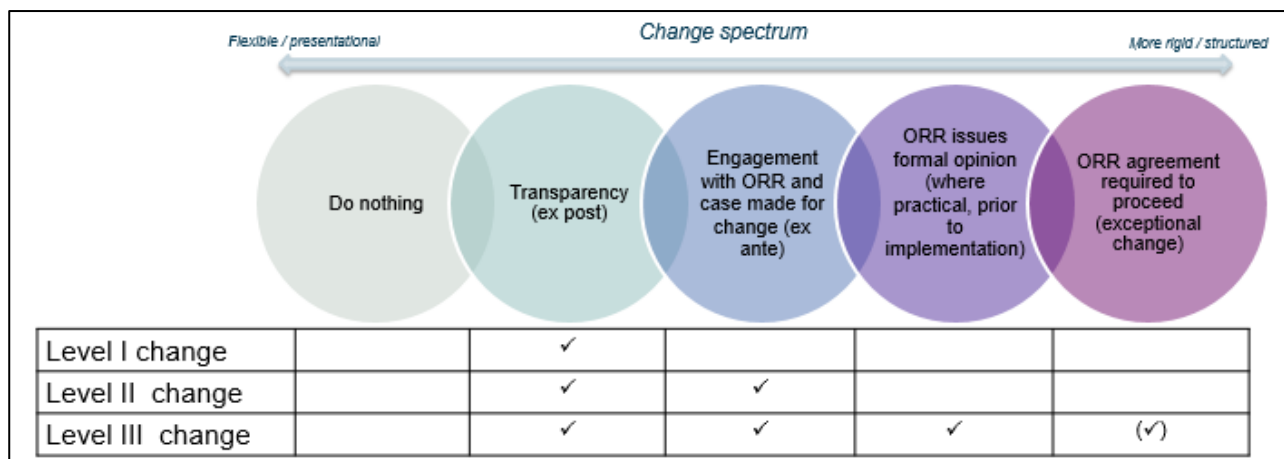
Levels of in-scope changes

31. We are categorising extra-route changes into three levels. We define the levels as follows:
- Level I and above: a change relative to our PR18 settlements;
 - Level II and above: a material change relative to our PR18 settlements; and
 - Level III: a fundamental change relative to our PR18 settlements.
32. We therefore propose that level II and III changes are those that:
- might occur to the routes or the SO that would not occur if they were independent commercial businesses ('extra-route changes'); and
 - could materially undermine their regulatory settlement, in particular with respect to the scope of their responsibilities, their funding and what they are expected to deliver.
33. Further detail on how changes could be categorised in this way is included in Part 2 of this paper.

4. Treatment of changes

34. The category that a change falls into will inform the process that needs to be completed as part of the managing change process. This is set out in Figure 1.2.

Figure 1.2: Reporting and process requirements for the different levels of change



35. We envisage the different levels of change being reported in the following ways:

- **Level I changes:** all in-scope changes, including level I changes, should be reported through change logs. The impact of changes may be presented on an aggregated basis as appropriate to support inter-year comparisons;
- **Level II changes:** Network Rail should also engage with us ahead of a decision on a level II change taking place and set out the governance arrangements it has followed, including appropriate stakeholder engagement. This would give us, and others, an opportunity to consider the impact of the potential change and discuss any concerns with Network Rail where appropriate; and
- **Level III changes:** We will publish a formal opinion on the change prior to its implementation and will consider updating baselines against which we monitor performance where appropriate.

36. For level II and III changes, we will seek assurance that a proportionate analysis of the change has been completed by Network Rail. We will compare the net benefits of the change with its impact on the regulatory settlements, and for level III changes we will provide a view on this by balancing our statutory duties.

37. In certain exceptional circumstances we would be able to use Network Rail's licence to prevent change, or consider reopening our determination. We set this out in the next section. Further detail on the reporting requirements, governance process and how we will treat each level of change is set out within Part 2 of this paper.

5. Prevention of certain changes

Where we would consider preventing change

38. To further help protect and preserve the benefits of the routes' and SO's settlements, we are considering amending Network Rail's licence to deal with certain cases where we would wish to prevent a change. In such cases, for Network Rail to proceed with the change would likely amount to licence breach.
39. We think that these cases would be when:
 - for a narrow set of level III changes, we have provided an opinion that we do not support the change ('an exceptional change'); or
 - the necessary process, for example effective engagement with affected train operating companies (TOCs) and freight operating companies (FOCs), has not yet taken place.
40. We discuss each of these in turn below before noting an alternative of reopening our determination.

Prevention of exceptional change

41. We anticipate that a licence-based mechanism should only apply in exceptional, narrowly defined circumstances. We refer to this as 'exceptional change'.
42. We propose that an 'exceptional change' is a level III change when there is no reasonable means available to us to mitigate the serious impact of the change on our ability to compare the financial and operational performance of the routes and the SO. What is reasonable or unreasonable would be informed in part by the justification for the change, and the benefits it would bring to Network Rail, passenger and freight rail users and taxpayers. We would take account of our statutory duties in reaching a decision.
43. An inability to compare the performance of the routes would fundamentally undermine one of the main benefits of PR18, which is about driving incentives, efficiency and performance through comparison. This is why we believe it is important to preserve the aspects of the settlements that are fundamental to achieving this objective.
44. We do not at this stage have a fixed definition of what might constitute exceptional change. Possible examples of circumstances whose effects we would not reasonably be able to mitigate are:
 - a reduction in the number of routes;

- routes losing much of their responsibilities (and hence comparisons lose their meaning because their performance is not independent of each other); and
 - changes that result in fundamental overhauls of business plans, in turn undermining different aspects of multiple settlements.
45. Regulators in other industries have made use of similar measures, for example the merger regime in the water industry requires that there is an assessment of the impact of a proposed merger on Ofwat's ability to make comparisons between water companies.
46. In many circumstances, the negative impact of a proposed change on the settlement(s) could be mitigated through, for example, enhanced reporting arrangements, or could be sufficiently justified by reference to the benefits it would bring to Network Rail. We are currently considering with Network Rail whether to reflect route devolution in the Network Rail licence (e.g. to restructure the licence obligations to better reflect the separation of functions between its routes, including potentially distinguishing between the Scotland route and other routes, the SO and its other functions - with all obligations still being owned by Network Rail as a company). If it is decided to embed the devolved structures in the licence, then this will necessarily prevent certain substantial changes to those structures. In any event, we will need to consider including a licence condition specifically relating to undermining the regulatory settlements, if we decide to manage exceptional change as described here.

A failure of process

47. We anticipate that a failure to adequately follow the managing change process would have licence implications regardless of the level of change at issue. A level III change would come to us for an opinion and compliance with the process may be considered in that opinion. A failure of process in respect of level II or III changes might come to our attention via the notification process or from those impacted.
48. A material failure to comply with the managing change process, or a lack of analysis, would be likely only to delay the change's implementation. If we indicated that a level III change must not be progressed on this basis, then we anticipate Network Rail would be able to remedy the failure and bring the change for our further consideration.

Re-opener mechanism

49. To complement this approach, we would also need to consider its interaction with our ability to rely on an existing ('re-opener') provision in part 7 of schedule 7 of the access agreements of franchised operators for ORR to conduct an interim access

charges review in certain circumstances before the date on which the control period would otherwise end). There may be some circumstances where the balance of our statutory duties supports reliance on this 'reopener' provision in preference to indicating that the change must not progress, and vice versa. Amendment of the reopener provision may aid its interaction with our proposal to indicate that a change must not progress, and again, this is something on which we would consult separately.

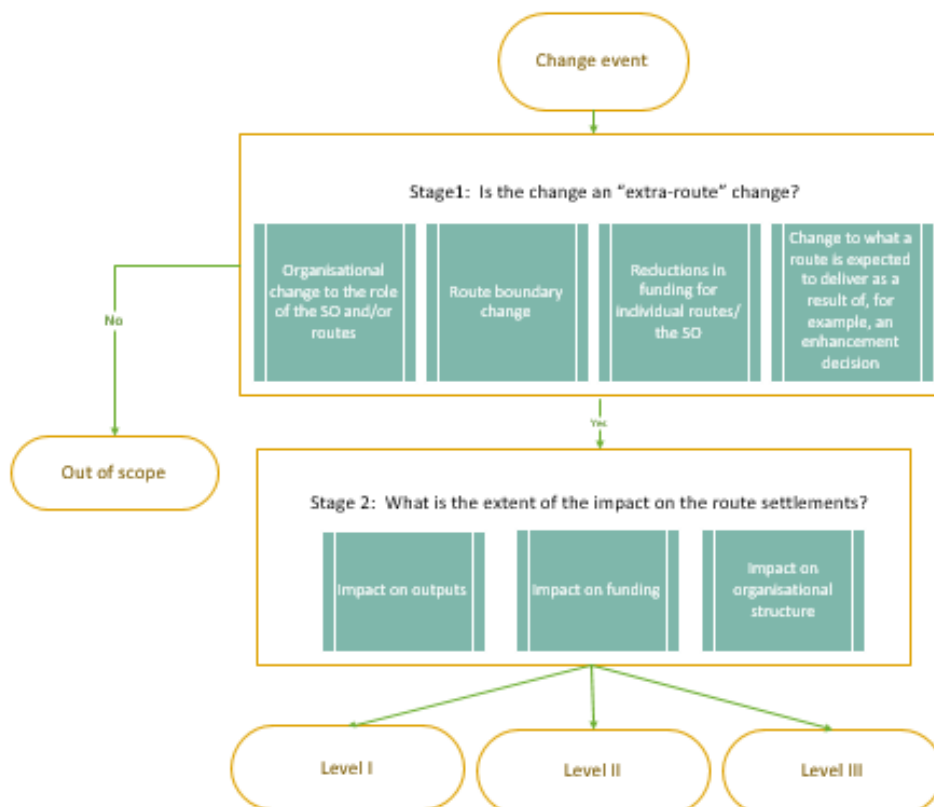
PART 2: THE MANAGING CHANGE PROCESS

Part 2 goes beyond the overriding policy outline and objectives and sets out further detail on how we envisage the managing change process could work in practice for different types of change. We have considered Network Rail’s existing processes and have proposed reporting requirements which complement those ways of working wherever possible.

6. Levels of change

- 50. In this section we set out how we propose to categorise extra-route changes, into level II and III changes. It is important that, where reasonably practicable, Network Rail alerts us to all potential level II and III changes prior to the change decision being made. In the case of level III changes, Network Rail should not proceed with the change prior to us giving an opinion.
- 51. In Part 1 we defined level II as being material changes relative to our PR18 settlements; and level III as being fundamental changes relative to our PR18 settlements. In this section we explain what we think this means in practical terms.
- 52. As set out in Figure 2.1, the categorisation of changes under the managing change process can be broken down into 2 stages.

Figure 2.1: Categorisation of changes



53. Stage 1: identify whether a change could impact what could be delivered under the route settlement. As outlined in Part 1 of this paper, this will be the case if the change is extra-route, and typically takes the form of:
- organisational changes – substantial to the role of the SO and/or routes;
 - route boundary changes (not ordinarily applicable to the Scotland route);
 - reductions in funding for individual routes (not ordinarily applicable to the Scotland route)/the SO; and
 - changes to what a route is expected to deliver as a result of, for example, an enhancement decision.
54. Stage 2 is set out in the next section.

Categorisation of level II and level III changes

55. In this section we set out our proposals for key examples of what constitutes level II or level III changes. We do this with respect to the expected impact on route/SO:
- outputs;
 - funding; and
 - organisational structure

Impact on route outputs

56. There are two key phases with respect to the changes to outputs:
- the first phase is the decision to make the change, for example the decision to fund an enhancement. The managing change process relates to this phase. At this point routes (or potentially the SO) should identify and assess the potential impact on what they can be expected to deliver; and
 - the second phase, potentially months later, is the updating of scorecards and any other business plan commitments to reflect lots of different developments including any changes that have been through the managing change process. This is not ordinarily part of the managing change process, and we would only seek to link the second phase to the first by exception if we had particular concerns. Only where Network Rail propose to change key definitions within the scorecards do we propose that scorecards form part of the managing change process.

57. Building on the principles for what constitutes level II and level III changes, we propose that the impact of extra-route changes on route / SO outputs will be categorised as shown in Table 2.1.

Table 2.1: Categorisation of the impact of extra-route changes on outputs

Categorisation of the impact of extra-route changes on outputs	
Level II and above	It has a material impact on what the route/SO is expected to deliver relative to the PR18 settlements (such that the route/SO may wish us to take it into account, where relevant, in our monitoring)
Level III	It has a fundamental impact on what the route/SO is expected to deliver relative to the PR18 settlements (such that direct comparison with the settlements in the relevant area becomes meaningless).

58. We will set out what we expect the routes / SO to deliver as part of our draft determination. For the geographic routes, we propose that for the managing change process this will relate to expectations with respect to the consistent measures in their scorecards.
59. For the FNPO we would seek to adopt an analogous approach, reflecting freight measures in particular. We think that there is sufficient flexibility in how we propose to regulate the SO, that this process with respect to outputs need not apply to the SO.
60. By 'material' in this context we mean such that the route wishes Network Rail and/or ORR to take account of the consequence of a change in its monitoring and reporting of that route. Provided that the route is suitably engaged in the change under good internal governance, we would anticipate the onus to be on the route to propose what the impacts would be and propose subsequent adjustments to scorecard targets to account for extra-route changes, where they can evidence them.
61. By a fundamental impact we mean an extra-route change that has a sufficiently large impact to render comparison to the settlements, in the relevant areas, meaningless.
62. Consistent with good practice, we expect Network Rail to engage appropriately with stakeholders on changes that impact on their service to those stakeholders.

Impact on route/SO funding

63. The settlements included within our PR18 determination will set out funding for each of the routes and the SO for each year of CP6. This is set out in more detail in our second consultation on the PR18 financial framework⁶.
64. Funding for Network Rail in Scotland is ring-fenced for CP6, and so would not ordinarily be subject to the changes we consider in this section.
65. There may be good reasons why Network Rail needs to adjust its budget allocations within England & Wales, relative to the PR18 settlements, over the course of the control period. Flexibility is needed to allow Network Rail to adjust to changing circumstances, of which there will be many, and deliver on its commitments efficiently.
66. However, larger changes to the size of a route/the SO's funding allocation are likely to have a material impact on the route's/SO's ability to plan, hence undermining the benefits of the settlement. (They may also change what they are expected to deliver, as covered in the previous section on outputs). Such changes are therefore within scope of the managing change process.
67. As part of its strategic business plan, Network Rail has proposed the use of a 'group portfolio fund' (GPF) approach to managing most financial risks⁷ for England & Wales in CP6. Under this approach a portion of each route's revenue requirement for each year (proposed to be £2.6bn in total for CP6) would be committed to the GPF. Network Rail has proposed that each route would retain control of some of this money (c. £660m in total for CP6 at a 'route' level), with the remainder (c.£1.9bn) held corporately at a 'portfolio level'. Network Rail proposes to profile more GPF funding to the later years of CP6 to reflect the greater degree of planning uncertainty associated with them.
68. Network Rail's indicative analysis shows that their proposed funding allocations across the GPF reflect certain 'confidence levels' with respect to funding that are shown in Table 2.2.

⁶ <http://orr.gov.uk/rail/consultations/pr18-consultations/financial-framework-for-pr18>

⁷ Network Rail also proposes to manage some risks by purchasing insurance from commercial providers but the scope of this coverage is more limited than in CP5 because of reclassification.

Table 2.2: Network Rail’s proposed funding allocations for England & Wales

Funding allocation	Route level confidence level
Route strategic plan	P50 – i.e. 50% chance that the route will deliver its outputs
Route strategic plan + route level GPF	P60 – i.e. 60% chance that the route will deliver its outputs
Route strategic plan + route level and portfolio level GPF	P80 – i.e. 80% chance that the route will deliver its outputs

69. As we explained in our financial framework consultation, we are currently considering the GPF approach alongside other options. In addition, to date we have not assessed the confidence levels with respect to the GPF funding allocations, which are based on Network Rail’s plans for managing financial risk.
70. In addition, Network Rail will need to comply with any government budgeting rules, which may relate to restrictions on reallocation of funding between years and across expenditure categories.
71. If we adopt the GPF approach outlined by Network Rail and accept the confidence intervals that they have calculated, as part of our determination, then under the managing change process we propose to categorise the levels of changes to routes and the SO’s funding as shown in Table 2.3.

Table 2.3: Our proposed categories for changes to funding for England & Wales

Reduction in route/SO funding	Timing	Change level
Below P60 level	As part of business planning update	level II
Below P60 level	Outside business planning update	level III
Below P50 level	Any time	level III

72. We distinguish between changes that occur within and outside the business planning process because the latter is more unexpected, further impacting the route/SO’s certainty of funding and associated ability to plan.
73. On the basis of Network Rail’s proposals, the full GPF should cover financial risks up to a P80 level of confidence and so a level II or III change of this kind might be expected to occur rarely.

74. Our focus is on reductions in routes' or the SO's funding because this particularly undermines their ability to plan, and hence the benefits of assurance regarding five years of funding that comes from our PR18 settlement. An increase in a route's budget, for example in the form of a GPF distribution resulting from outperformance or upside risk, is not within the scope of this process. Consistent with the terms of the network licence, we would expect the route to put the funds to good use. It would be scrutinised through our annual efficiency assessment, and through our monitoring more generally.
75. In the event that Network Rail does not have a GPF, or arrangements are otherwise changed, we would need to reconsider how we would categorise financial changes.

Impact on organisational structure

76. In our 2017 overall framework consultation we said that while we would expect to be informed about any significant planned change to Network Rail's organisation, we would only consider being formally involved in a change management process with respect to how Network Rail is organised when this has a significant impact on routes' responsibilities, or that of the SO.
77. As part of our wider work on PR18, we are considering whether the roles and responsibilities of different Network Rail functions will be set out within the Network Rail licence or subsidiary documents. In these circumstances, we would propose to categorise the change based on the extent to which there is a deviation from these defined roles. This would then constitute a level II or level III change.
78. Our concern is with a change that diminishes the roles of the routes and/or SO, not of increasing them.

7. The managing change process

Overview of process

79. As already outlined in Part 1, the managing change process varies according to the level of the change:

- **Changes that are level I and above:** all in-scope changes, including level I changes, should be reported through change logs. The impact of changes may be presented on an aggregated basis as appropriate to support inter-year comparisons;
- **Changes that are level II and above:** Network Rail should also engage with us ahead of a decision on a level II change taking place. This would give us, and others, an opportunity to consider the impact of the potential change and discuss any concerns with Network Rail where appropriate; and
- **Level III changes:** we will publish a formal opinion on the change prior to its implementation and will consider updating baselines against which we monitor performance where appropriate. For certain exceptional changes, we may prevent the change under the terms of the licence.

Reporting requirements for level I changes and above

80. This section outlines the, typically annual, reporting requirements and liaison for all in-scope changes (level I and above). Additional arrangements for level II and III changes are set out in the next section.

81. We will set out reporting requirements for Network Rail for CP6, primarily for monitoring and enforcement purposes. This will be detailed principally in our data protocol, and also in our regulatory accounting guidelines. In addition we have requirements relating to the publication of scorecard information.

82. In our 2017 overall framework consultation, we said that we would expect small changes to be dealt with, as now, in aggregate. This would probably be through annual reporting arrangements which outline changes to the business plans. Information might be presented in aggregate, to support inter-year comparisons.

83. The reporting requirements would seek information on:

- the changes themselves, with supporting detail; and
- the articulation of the impacts in routes' plans and scorecard targets and/or in outturn performance.

84. Our early discussions with Network Rail suggest that this might include a business plan change log, potentially focused on changes to scorecards, cost and volumes, with commentary against each item. This would better enable ORR to link the change events to the adjustments to the business plans and, in turn, help us to compare performance against the settlements.

Reporting requirements for level II changes and above

85. In addition to these underlying reporting requirements that apply for all changes, level II and III changes carry additional reporting requirements.
86. Some changes in scope have a highly developed governance process. Where this is the case, we propose that Network Rail will have reporting requirements that are adapted to make best use of the existing process, subject to our prior agreement. We anticipate that this will apply:
- for changes to routes'/SO funding, according to the business planning process; and
 - for enhancements, according to the process around funding decisions (according to the processes established for Scotland and, separately, for England & Wales, as well as for non-national funders).
87. We anticipate that all other in-scope changes will utilise the managing change process outlined below – which we are referring to as the “generic” managing change process. This will apply to:
- organisational change;
 - change to route boundaries; and
 - other changes not mentioned above that affect what the route is expected to deliver.
88. We set out the generic process. In section 8 we discuss arrangements that would be complementary to the business planning and enhancement processes.

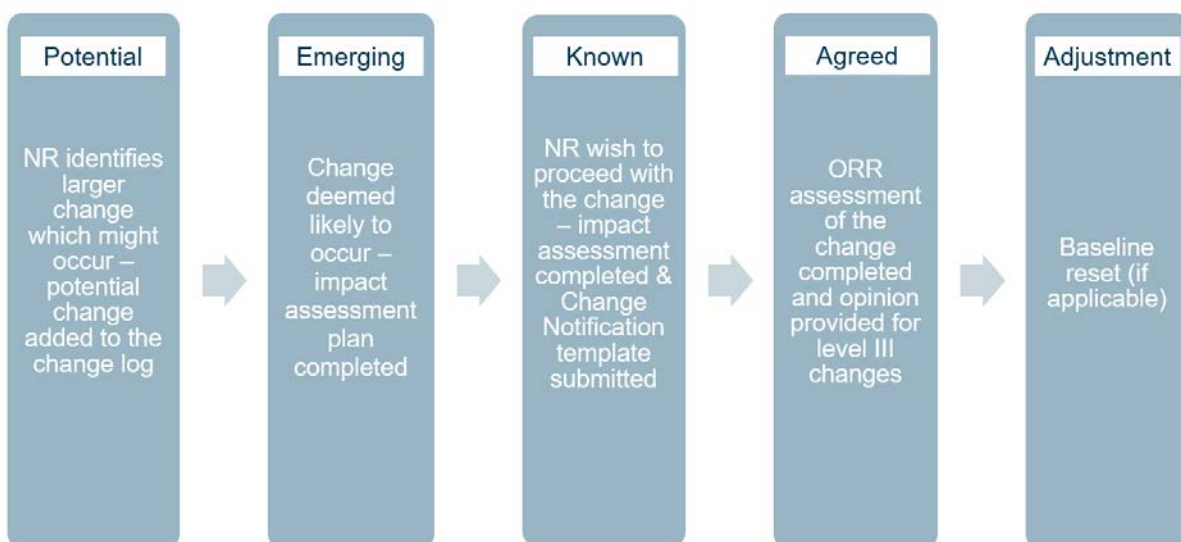
Managing change generic process

89. We require that Network Rail makes the case for change in a way that is proportionate, effective and clear. We propose that this has the following dimensions:
- describing and explaining the change and its rationale; and
 - assessing the impact on the settlement, and outlining the action taken to minimise the impact, including:

- Internal governance: the ability of the routes / the SO to plan for the change, to be consulted on and gain their support for the change, and remain accountable for their route/SO's performance; we would ordinarily expect that larger changes would be signed-off by the affected route managing directors prior to implementation;
- Stakeholder engagement: form of engagement, stakeholders' views and how the change was amended as a result;
- Competition and comparison: supporting comparison as a time series/relative to target/across routes, supporting competition between the routes and our ability to hold routes to account; and
- Consideration of the impact (in a format that will relate to subsequent scorecard and business plan updates).

90. The type of changes that will be included in this process will often evolve over time as further analysis is completed and more information about the proposed change emerges (analogous to the enhancements pipeline process). We therefore propose the use of a dynamic reporting process which will allow for a clear and proportionate communication process between Network Rail and ourselves over the change 'life-cycle', as set out in Figure 2.2. This would allow ORR to engage on plans for change, therefore expediting the managing change process.

Figure 2.2: A possible approach to reporting over the change 'life-cycle':



Box 2.1: managing change governance process (level II and III changes)

Step 1 – Business as usual: The route/the SO identifies an upcoming potential level II or level III change and engages with ORR as part of its regular meetings, as well as with stakeholders as appropriate.

Step 2 – Network Rail submits the formal **Change Notification Template** (see Appendix B) to ORR, complete with the required information, including supporting documentation/cross reference to other documents; it may request amendments to ORR’s monitoring baselines as part of this.

Step 3 – Following receipt of Network Rail’s formal submission, ORR will (i) confirm or challenge the proposed change categorisation or (ii) seek further information from Network Rail if required. Where there is a requirement for further information, Network Rail will resubmit. Resubmission may be required until the requisite information has been provided.

Step 4 (level III only) – the ORR will provide a formal view on the proposed change within an agreed period of time⁸ after receipt of all necessary information.

Step 5 (level III only) – if requested by Network Rail, we will consider taking certain changes into account when assessing performance against the settlements

91. The change notification template should be used as a guide to the information that should be provided alongside a material change. Network Rail should focus on adopting a proportionate approach, summarising only the key facts concisely where possible.
92. In addition, Network Rail needs the ability to make business decisions quickly where necessary. This is an important consideration and we will take this into account when providing a formal view on level III changes.

Adapting the process for emergency changes

93. Some changes are driven by shock events that cannot reasonably be anticipated - e.g. as consequences of extreme weather. Within England & Wales, this may result in Network Rail needing to make a level II or III change because of the consequences

⁸ We note that for Track Access applications, ORR has to respond within 6 weeks following receipt of all necessary information. Some changes could require a similar level of scrutiny and so 6 weeks is considered to be a useful reference point.

that event has on other routes/the SO, notably if the proposed response involves reductions in other routes' funding.

94. We propose to require that our managing change process be followed as far as is reasonably practicable. This means that the managing change process would not hinder or delay an emergency response in situations where there is a clear case for change to be enacted quickly.
95. However, such situations are considered to be extraordinary and are expected to occur infrequently. We would expect Network Rail to be transparent about any emergency short term stabilisation changes made, with details of the changes made to be provided through the managing change process at the earliest available opportunity. For any future related changes, the managing change process should be used in the normal way.

Management of the process within Network Rail

96. Because we are mainly concerned with extra-route changes, we anticipate that the business review team or the executive, or the SO in the case of enhancements, would take responsibility for much of the process:
 - **Reporting change:** we would expect the route/SO to be responsible for updating and reporting on the change log as part of the annual business planning update across all change categories;
 - **Categorising the change:** central Network Rail (or the SO for enhancements) would be well placed to identify level II and III changes. We would expect it to initiate/be closely involved in all such changes with input from affected routes/the SO;
 - **Making the case for change (and submitting to ORR):** we would expect the centre/SO to lead this process, with inputs from affected routes/SO; and
 - **Stakeholder engagement:** conducted proportionately at the most appropriate level.

ORR opinion and decision on level III changes

97. Through scrutiny of the Change Notification template and accompanying information, we will verify that a robust evidence-based analysis of the change has been completed by Network Rail. We will compare the net benefits of the change with its impact on the regulatory settlements and for level III changes we will provide a view on this by balancing our statutory duties.

8. Arrangements for specific processes

98. In general, where Network Rail already has governance processes or reporting requirements that partially or fully meet the needs that we set out in this working paper, we propose to make use of them and avoid duplication. The underlying principles and information requirements remain, but may be met, subject to our prior agreement, with reference to existing processes.
99. We know that this is particularly the case with respect to enhancements, and that we would also seek to use the existing business planning processes and processes around updating scorecards. We set each of these out in turn.

Business planning and reductions in routes' or SO's funding

100. This section relates principally to England & Wales.
101. Network Rail updates its business plans at least annually to reflect the prevailing circumstances facing the business. The business plan updates will be affected by any material extra-route changes that have occurred in the preceding period but will also incorporate the effects of a plethora of other changes which are outside the scope of the managing change process. We may be interested in these updates for monitoring or enforcement purposes, but consider such updates to be largely outside the scope of this working paper.
102. However, within England & Wales, it is possible that the business plan update will result in a reduction in funding of a route or the SO (over and above a group portfolio fund). Such a change is in-scope of the managing change process as it may reduce the benefits of the settlements by affecting routes' and the SO's ability to plan, with potential consequences for their efficiency and incentives to deliver.
103. It is important that there are strong governance processes in place to minimise the negative impact of such changes. In particular, it is crucial that the route managing directors are engaged with, contribute to, and sign-off the updates, so that they retain ownership of their business plans.
104. Network Rail has explained to us that the route managing directors are already closely involved in the business plan updates, and it is concerned about us inserting controls around changes to routes' funding. Currently, the process for updating routes' business plans, including their work banks and budgets, is highly iterative and may be driven not by a material distinct event, but by the cumulative effect of a number of more modest deviations from the plan. We therefore expect to be able to work with Network Rail before the start of CP6 to ensure that we are content with the internal governance arrangements it establishes around updating routes' and the

SO's business plans (and, similarly engagement with stakeholders, notably with respect to route and SO scorecard updates). The stronger this governance, and transparency of reporting, the more light touch we can be.

105. This engagement will allow Network Rail to alert us early to potential issues that might trigger a level II or III change to route or SO funding (for which we will require ex-ante notification), and confirm that appropriate governance is being applied. They would be able to make an informal submission of the pre-agreed information, so that any unanticipated issues could be addressed in good time. Under current arrangements we would expect such a submission at the time that the centre issued planning assumptions to routes, including assumptions regarding route budgets, if the planning assumptions included level II or above changes.
106. For level III changes, which should occur only a small number of times in a control period, we would then be able to prepare our opinion of the change while the updating was in process, minimising the impact on the timing of the business planning process.
107. The governance arrangements and opinion would be subject to materiality thresholds, so subsequent small changes to funding would not require a full repetition of the managing change process.
108. Business plan updates are important to us in a number of respects beyond reduction to route/SO funding, not least for monitoring financial efficiency and tracking delivery. We expect to engage regularly with the routes, the SO and the centre about changes to business plans as part of the liaison arrangements we establish with Network Rail for CP6.

Updates to routes' scorecards

109. Updates to scorecards in CP6 will primarily occur outside of the managing change process with Network Rail agreeing updates to its targets with its customers, ordinarily on an annual basis.
110. Provided that a customer-agreed route/SO scorecard continued to meet our requirements, as set out in our overall framework conclusions, we would not expect to be involved directly in the process for implementing changes to it. However, for us to place weight on the revised target in our monitoring, we would expect to be informed of stakeholders' views regarding the change and the governance around the change.

111. We propose that the managing change process is used to consider changes to the consistent measures⁹ on the route comparison scorecard, which are the principal measures we will use to compare performance. Changes to the measures included in the scorecard, the calculation methodology, or the PR18 baseline would need to follow the following process:

- Change in measures or the calculation methodology: we propose that a material change to the measures included in the route comparison scorecard or the calculation methodology amounts to a level III change, because it may fundamentally undermine our ability to compare performance. Consistent with our overall approach, we would therefore require Network Rail to submit to us the case for making the proposed change and the governance around the proposed change. We would subsequently issue a formal opinion on the change.
- PR18 baseline: in the event that an extra-route change fundamentally undermines the relevance of a PR18 baseline trajectory for a consistent measure, as part of the managing change process outlined in Box 2.1, a route may request that the impact of the change is taken into account by changing the baseline for our monitoring and reporting. We will consider whether an amendment is warranted.

112. Separately, a change to the minimum regulatory floor would require our approval. This might occur, for example, following enforcement action.

Impact of enhancements with respect to PR18 settlements

113. We anticipate that a number of enhancements will be funded during CP6 that, consistent with relevant funders' HLOSs, do not form part of routes' strategic plans or our determination. The arrangements will differ for Scotland and for England & Wales, and some will be funded by third parties.

114. The change event is the decision, taken by the funder with agreement from Network Rail, to fund delivery of the enhancement (rather than, for example, the incorporation of the enhancement in routes' business plans, or the consequential update to the train timetable). For the avoidance of doubt, the ORR process would not approve or seek to prevent an enhancement project from proceeding. Rather, the change process seeks to ensure that the consequential costs of the enhancement are taken into account and that adjustments to targets and business plans take place in a structured and transparent manner. During CP6, we will require that Network Rail report to us on enhancements on an ongoing basis. We will set out our policy for

⁹ We propose this includes both ORR's and Network Rail's consistent measures.

monitoring enhancements in our Monitoring and Enforcement Policy later in the year. While new enhancements will be outside our PR18 regulatory settlement, they will be an important activity for Network Rail, which we need to take into account in our monitoring and reporting, notably in our Network Rail monitor publications.

115. As set out in this paper, our focus is on extra-route changes that materially affect the settlements (level II and level III changes). Enhancements that are outside scope are those that do not materially reduce the effective funding that the route has for its other activities, or do not affect its regulatory scorecard targets (i.e. targets relating to the route's consistent measures).
116. We anticipate that the SO would oversee the process for managing change affecting the PR18 settlements with respect to the decision to fund enhancements, working with the routes concerned.
117. For level II changes, our focus is on supporting good governance. In the case of enhancements, a number of mature governance arrangements are already in place; for example engagement with operators through the Network Change process; and governance is being developed further. We propose that we make best use of these processes. In particular, we propose to exempt enhancement change from certain reporting requirements conditional on specific governance arrangements, which we would approve, being followed.
118. For each level II and level III enhancement change event however, we do anticipate that we would require information regarding the impacts of the enhancement decision on each route's settlement prior to the decision being made. We would also require assurance that this information would be used transparently in the decision making process.
119. Potential ways in which the enhancement could affect a route's settlement are:
 - Impacts on the route's ability to deliver its outputs through, including:
 - effects on its customers, e.g. improved train performance (as well as other benefits) following enhancement delivery; temporary worsening of performance during construction;
 - effects on renewals delivery, e.g. engineering access for the enhancement reducing the routes' access for renewals
 - Impacts on the route's effective level of funding through, including:
 - consequential changes to maintenance and renewals work banks
 - an enhancement decision impacting on demand for suppliers' services, which in turn affects the suppliers' unit costs and hence Network Rail's efficiency for the associated renewals – this could have the potential to have an impact beyond the route(s) directly affected by the enhancement.

120. Some enhancements have impacts in both Scotland and England & Wales. We discuss cross border enhancements in our financial framework consultation.
121. In addition, there are implications for the enhancement process, if the CP6 change process is to work effectively. In particular, it will be easier to agree the necessary changes to performance, maintenance and renewals if these impacts are set out in the enhancements' business case. This may be at a relatively high-level, but would provide a basis upon which detailed discussions can take place.
122. Reflecting this, we expect the effort to be made in appraising these impacts to be proportionate, for example relative to other impacts included in the enhancement business case (and, consistent with best practice appraisal, some impacts may be expressed in qualitative terms only). We recognise that there are inherent uncertainties in estimating impacts prior to full updates to business plans.
123. For level III change events, in addition to the level II process, we set out our opinion regarding the proposed change before the decision is made. In the case of enhancements, it is for the relevant funder, together with Network Rail, to decide whether to fund a particular enhancement. We will not give our opinion on that decision. Rather we will focus on whether the impact on routes' PR18 settlements has proportionately been taken into account in the information being compiled to support an enhancement investment decision, and that the proposed funding for those sets of business plan impacts is appropriate.
124. In certain cases (as with the other level II and III changes outlined in this paper) where we do not consider that the impacts have been appropriately taken into account, either at the time of the enhancement decision, or in the subsequent business plan update, we may investigate whether a licence breach has occurred. (This may be under a condition broadly similar to the existing condition 1 of the licence, or an embedded new provision.) For very large changes, the reopener provision in the track access contracts may also apply.

Appendix A: Assessment of impacts of the managing change process

Stakeholders	Responsibilities	Benefits and costs of this process
Routes	Maintaining certain databases – advising the centre on scale of impacts: these activities should occur irrespective of this process	Supports route businesses by ensuring that disruption is better taken into account in decision making and offers a mechanism by which mitigating circumstances can be taken into account (through the adjustment of baselines).
Network Rail centre	Overall responsibility for this process, including identifying and making the case for the relevant changes	We are seeking to minimise the administrative costs of this process by drawing on existing processes.
National funders of enhancements, and SO interface	Funders' and the SO's work to improve governance around enhancement decisions means that the additional reporting requirements will be minimal	This process will support improvements in governance being made by national funders and the SO. They mean that the impact on route businesses' efficiency and delivery is better taken into account in enhancement decisions.

Appendix B: Generic change notification template

For level II and III changes, to be completed by Network Rail & submitted to ORR

Change Code Number	
Change Title	
Submitter	
Date of Change Request	
Change category (proposed)	<i>Level II / Level III</i>
Change Type	<i>Enhancement / Financial / Organisational / Route boundary / Other</i>
Sub-change Type	
Route(s) affected	
PR18 Baselines materially impacted	<i>Y/N</i>
Change Description	
<i>Describe the change in as much detail as needed to make the situation clear for readers.</i>	
Reasons for change and urgency	
<i>Describe what will happen if there is no change and outline timeframes for implementing the change.</i>	
Options analysis	
<i>Outline the options considered when assessing whether to make the change.</i>	
Impact assessment	
<i>Assess the costs & benefits and risks of making the change – referring to other documents where appropriate. This should include consideration of the extent to which there will be an impact on:</i>	
<ul style="list-style-type: none"> <i>(i) customers / end-users & other stakeholders</i> <i>(ii) the PR18 settlements (outputs / funding / organisational structure)</i> <i>(iii) the route based regulatory framework (the ability of routes to plan / accountability of routes / the ability to compare performance across routes)</i> 	
<i>Specify how the change is being implemented to retain our ability to make comparisons.</i>	
Route/SO engagement	
<i>Describe how the impacted route(s)/SO have been involved in the process and the extent to which they are supportive of the change as outlined.</i>	
Stakeholder engagement	
<i>Describe what stakeholder engagement has been completed, the responses received and evaluate any material concerns raised.</i>	
Scorecards & reporting	
<i>How might scorecard targets be affected by the change? How will Network Rail reporting reflect the change (including at route level).</i>	
Recommendation	
<i>Summarise why the benefits of making the change are deemed to exceed the costs.</i>	



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